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FOR ACTION

A SELF-FINANCING SUPPLY DIVISION

SUMMARY

The present report was prepared in response to comments made by the Advisory Committee on Administrative and Budgetary Questions (ACABQ) concerning the difficulty of establishing the actual cost of UNICEF supply operations. ACABQ, which made these comments in its report on the UNICEF administrative and programme support budget for 1994-1995 (E/ICEF/1993/AB/L.2), suggested that steps be taken to represent more clearly, as part of the budget, the real cost of supply activities to the organization.

The Executive Director recommends that the Executive Board decide that the UNICEF Supply Division shall become a self-financing unit, within the structure of the administrative and programme support budget.

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I. A SELF-FINANCING SUPPLY DIVISION

1. The report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) on the UNICEF administrative and programme support budget for 1994-1995 (E/ICEF/1993/AB/L.2) drew attention to the difficulty of establishing the actual cost of UNICEF supply operations and suggested that steps be taken to represent more clearly, as part of the budget, the real cost of supply activities to the organization. The proposal which follows addresses the reservations contained in the ACABQ report.

2. In 1993, the UNICEF Supply Division placed in excess of 12,000 orders, all from Copenhagen and New York, with more than 3,000 suppliers. If the total volume of purchases placed worldwide is included, the number rises to more than 23,000.

3. All UNICEF purchasing activities are managed from Copenhagen, although the value and proportion of UNICEF procurement from developing countries is higher than that of any other United Nations organization, amounting to $101 million in 1993.

4. Given the increasing contribution of the UNICEF Supply Division both to development assistance and to emergency relief, the observation of ACABQ about the lack of transparency with regard to the costs of UNICEF supply activities presents a timely opportunity to introduce a clearer presentation of the Supply Division budget. Other observations made by ACABQ concerning the structure of the Supply Division and the continuing split of the Division between New York and Copenhagen will be addressed in the administrative and programme support budget for 1996-1997, which will be presented to the Executive Board in 1995.

5. At present, the Supply Division budget has four subdivisions: (a) Copenhagen administration; (b) Copenhagen warehouse; (c) New York administration; and (d) category III - packing and assembly activities.

6. Before 1983, the warehouse was a separate, self-financing entity with a variable overhead recovery which financed the costs of warehousing and packing. After consolidation, a "category III" of the UNICEF budget, consisting of the costs of warehouse labour and packing materials, was created as a charge to the budget. These costs should more correctly be presented as a charge on programmes. The "overhead" on supplies entering the warehouse was fixed at 10 per cent in 1983 and forms the major part of the line "income to the budget" in the administrative budget.

7. All operating costs of the Supply Division (heating, electricity, equipment, etc.) for both the purchasing activity and the warehouse are charged to general resources through the administrative and programme support budget. Staff and related costs, however, are paid from three sources: (a) general resources; (b) supplementary funds; and (c) procurement services. None of the operating costs are set against the recovery generated by charges on deliveries from the warehouse. This "recovery" is currently credited as income to the administrative budget.

8. The present mechanism for budgeting the costs of the supply operation and accounting for expenditures does not permit a transparent presentation of the cost of Supply Division activities in relation to the expenditure on supplies and equipment, which totalled $373 million in 1993. This lack of clarity is compounded by charging programme delivery costs, in the form of the contracted warehouse labour used for packing of warehouse supplies and the packing materials for those supplies, to the administrative and programme support budget.

9. Although the major function of the Supply Division is to provide supplies and equipment to UNICEF-assisted programmes, a significant secondary workload is generated by requests for procurement services by Governments, non-governmental organizations and other United Nations bodies. However, the Supply Division in effect receives orders from customers and fills those orders, whether they are for items shipped directly from suppliers or items shipped from the warehouse, or whether they are for UNICEF or non-UNICEF customers.

10. As the Supply Division operates a complete purchasing, warehousing and packing function, it is more appropriate, from an accounting and cost-recovery perspective, that all external and internal "customers" pay for the purchasing services from which they benefit.

11. The Executive Director proposes the creation, within the UNICEF budget structure, of a self-financing Supply Division which will charge each "customer", whether a UNICEF country office or a procurement services client, a fee for the service of purchasing and delivering the requested supplies. Thus, all costs will be financed from a charge made for the provision of purchasing and warehousing services, whether to UNICEF-assisted programmes or procurement services customers.

12. The procurement services account will continue to be managed separately, but all income to the account, after the payment of staff and related costs, will be credited to the Supply Division account. The first charge on the income generated from general resources and supplementary funds purchases will also be for staff and related costs. Other operational costs will be offset against the balance of the income generated.

13. It should be noted that the proposal to eliminate the 6 per cent recovery and charge the staff and related costs to the administrative and programme support budget (E/ICEF/1994/AB/L.2) will change the presentation of the Supply Division budget but will not change the overall costs or the proposed concept.

14. An accounting system appropriate to the needs of the cost-recovery process will be established, although the presentation of the Supply Division budget will continue to follow the format mandated by the Executive Board. The income generated will be applied to "production" (inventory and purchasing costs) through the full cost or absorption costing method, i.e., a cost accounting system wherein the full costs of producing the goods are "absorbed by" or charged as product cost. At the end of the year, income exceeding the actual costs will be credited to general resources as miscellaneous income. If the costs of the Supply Division operation exceed the income generated, the excess

will form an additional charge to the budget in the same manner as costs exceeding other budgetary allotments are presently covered.

15. The proposed format for the presentation of the Supply Division budget is shown in annex I. An accompanying change will be required in the Executive Board's budget resolution, which it is proposed would read as follows:

> "The Executive Board approves appropriations in the amount of $xxx,xxx,xxx gross, to be allocated from the resources indicated below, to finance the 19XX-19XX biennial budget and resolves that the recovery and income estimates in the amount of $xx,xxx,xxx shall be used to offset the gross appropriations, resulting in net appropriations of $xxx,xxx,xxx as indicated below."

16. A number of advantages of the Supply Division operating as a self-financing unit are discussed in detail in annex II.

II. RECOMMENDATION

17. The Executive Director recommends that the Executive Board approve the following draft resolution:

The Executive Board,

Having considered the proposal contained in document E/ICEF/1994/AB/L.9,

Taking into account the observations of ACABQ,

Decides that the UNICEF Supply Division shall become a self-financing unit within the structure of the UNICEF administrative and programme support budget. The new format for the presentation of the Supply Division budget will be considered by the Executive Board as part of the proposed administrative and programme support budget for the biennium 1996-1997, along with the observations of ACABQ.

Annex I

PROPOSED FORMAT FOR PRESENTATION OF THE SUPPLY DIVISION BUDGET
AS PART OF THE ADMINISTRATIVE AND PROGRAMME SUPPORT BUDGET

(Thousands of United States dollars)

	APPROVES	TAKES NOTE OF	
	Gross/net budgets	Extra-budgetary income a/	Total gross/net budget
1. Administrative and programme support b/			
Category 1a - International Professional costs	xxx,xxx.x	-	xxx,xxx.x
Category 1b - Local staff costs	xxx,xxx.x	-	xxx,xxx.x
Category 2a - General operating costs - headquarters	xxx,xxx.x	-	xxx,xxx.x
Category 2b - General operating costs - field	xxx,xxx.x	-	xxx,xxx.x
GROSS BUDGET	xxx,xxx.x	-	xxx,xxx.x
Estimated income	xx,xxx.x	-	xx,xxx.x
NET BUDGET	xxx,xxx.x	-	xxx,xxx.x
2. Supply operations			
Category 1a - International Professional costs	xx,xxx.x	xx,xxx.x	xx,xxx.x
Category 1b - Local staff costs	xx,xxx.x	xx,xxx.x	xx,xxx.x
Category 2a - General operating costs	xx,xxx.x	xx.x	xx,xxx.x
Category 3 - Packing and assembly costs	xx,xxx.x	xx.x	xx,xxx.x
GROSS BUDGET	xx,xxx.x	xx,xxx.x	xx,xxx.x
Estimated recoveries/income	xx,xxx.x c/	xx,xxx.x	xx,xxx.x
NET BUDGET	x.x	x.x	x.x
3. TOTAL UNICEF BUDGET			
Category 1a - International Professional costs	xxx,xxx.x	xx,xxx.x	xxx,xxx.x
Category 1b - Local staff costs	xxx,xxx.x	xx,xxx.x	xxx,xxx.x
Category 2a - General operating costs - headquarters	xxx,xxx.x	xx,xxx.x	xxx,xxx.x

	APPROVES	TAKES NOTE OF	
	Gross/net budgets	Extra-budgetary income a/	Total gross/net budget
Category 2b - General operating costs - field	xxx,xxx.x	xx,xxx.x	xxx,xxx.x
Category 3 - Packing and assembly costs	xx,xxx.x	xx,xxx.x	xx,xxx.x
GROSS BUDGET	xxx,xxx.x	xx,xxx.x	xxx,xxx.x
Estimated recoveries/income	xx,xxx.x	xx,xxx.x	xx,xxx.x
NET BUDGET	xxx,xxx.x	xx,xxx.x	xxx,xxx.x

a/ Extrabudgetary income represents income from external resources earned through procurement services to third parties.

b/ The Executive Director is permitted to redeploy between categories up to a maximum of 5 per cent.

c/ Recoveries represent charges to UNICEF programmes.

Annex II

ADDITIONAL INFORMATION: A SELF-FINANCING SUPPLY DIVISION

1. Since the creation of UNICEF, supplies and equipment have been an important component of its development assistance. In the 1940s and 1950s, UNICEF assistance in Europe and parts of Asia consisted almost exclusively of supplies in the form of food, clothing and medicines. As the organization evolved, the proportion of assistance made up of supplies and equipment diminished; it now forms approximately 50 per cent of UNICEF development assistance provided to more than 130 countries.

2. Recently, the provision of emergency assistance to such countries as Somalia and Liberia, as well as to the former Yugoslavia, has placed a new emphasis on the warehousing and set packing operations of the Copenhagen warehouse. However, the warehouse throughput still constitutes less than 30 per cent of the total supply component of development assistance provided by UNICEF.

3. The main function of the Supply Division is to provide the material component of the country programmes supported by UNICEF from general resources and supplementary funds income. These two sources each represent approximately 40 per cent of supply purchases. The Supply Division is increasingly providing procurement services to developing country Governments, non-governmental organizations (NGOs) and other United Nations organizations by acting as a purchasing agent. These activities make up the remaining 20 per cent of the purchasing activity.

Scope of presentation

4. In addition to the comments made by the Advisory Committee on Administrative and Budgetary Questions (ACABQ) about the lack of transparency regarding the costs of the Supply Division (see paragraph 1 of section I above), ACABQ also commented on the existing structure and the continuing split of the Division between Copenhagen and New York. Those concerns are not addressed in the present report, but will be addressed as part of the 1996-1997 administrative and programme support budget, which will be presented to the Executive Board, after review by ACABQ, in 1995.

5. The present report deals with a proposed revision in the budget presentation in response to the observation by ACABQ on the difficulty of establishing the true cost of supply activities. The report also explains how the costs will be recovered and how surpluses and deficits will be dealt with.

Present budgetary structure

6. The Supply Division budget is part of the overall administrative and programme support budget and has four subdivisions: Copenhagen administration; Copenhagen warehouse; New York administration; and category III - packing and assembly activities. The Division's budget is presented to the Executive Board in the format established by the Board.

7. Before the consolidation of the Supply Division at Copenhagen in 1983, the warehouse was a separate, self-financing entity. The "overhead" added to all supplies passing through the warehouse was based on a variable recovery (between 9 and 14 per cent), which financed the costs associated with the warehouse and the packing operation. At the time of consolidation, the budget for the warehouse became a part of the overall Supply Division budget. However, at that time the warehouse operation was not fully incorporated, as an expense, into the budget. Category III, consisting of the costs of warehouse labour and packing materials, was created as a charge to the budget, although these costs are directly associated with the delivery of supply assistance. They should more correctly be presented as a charge on programmes. The "overhead" on supplies entering the warehouse was fixed at 10 per cent in 1983 and forms the major part of the budget line, "income to the budget". The recovery generated from procurement services orders on the warehouse is treated as income to UNICEF and credited to the procurement services account. Procurement services income and expenditure are explained further below.

8. The operating costs of the Supply Division (heating, electricity, equipment, etc.) for both the purchasing activity and the warehouse are all charged to general resources through the administrative and programme support budget. Staff and related costs, however, are paid from three sources: (a) general resources; (b) supplementary funds; and (c) procurement services. As the recovery generated by the 10 per cent charge on deliveries from the warehouse is accounted as a general credit to the budget, no specific supply costs are debited against this income.

Shortcomings of the present structure

9. The present mechanism for budgeting the costs of the supply operation and accounting for expenditures does not permit a transparent presentation of the cost of Supply Division activities in relation to the expenditure on supplies and equipment, either in respect of direct purchasing ($272 million by the Supply Division in 1993) or in respect of warehouse throughput ($112 million in 1993). In addition to that direct purchasing, a further amount of $101 million was authorized by the Supply Division for purchase by UNICEF offices in assisted countries. Therefore, total purchases of supplies and equipment by the Supply Division from all sources in 1993 were $373 million.

10. The lack of clarity in the presentation of the costs of the Supply Division is compounded by charging programme delivery costs, in the form of the contracted warehouse labour used for packing of warehouse supplies and the packing materials for those supplies, to the administrative and programme support budget.

Reasons to change

11. The major function of the Supply Division is to provide a service to UNICEF-assisted programmes. The primary workload is generated by supply call-forwards issued by country offices for the provision of supplies and equipment for UNICEF-assisted development programmes.

12. As stated in section I above, these supplies may be funded either from general resources or supplementary funds income. A secondary workload is generated by requests for procurement services by Governments, NGOs and other United Nations bodies. However, the Supply Division in effect receives orders from customers and fills those orders, whether they are for items shipped directly from suppliers or items shipped from the warehouse, or whether they are from UNICEF or non-UNICEF customers. The purchasing and delivery of supplies is, therefore, independent of individual country programme activity, although input is provided to each programme. Therefore, UNICEF-assisted country programmes could be considered as discrete customers, as are procurement services clients.

13. The purchasing and warehousing operations are funded from a mixture of general resources, supplementary funds and procurement services. At present, procurement services recipients pay a handling fee for the services they receive. As the Supply Division operates a complete purchasing, warehousing and packing function, it is more logical, from an accounting and cost-recovery perspective, that all "customers" pay for the purchasing services from which they benefit.

How this can be achieved: proposal for clarity

14. The Executive Director proposes the creation, within the UNICEF budget structure, of a self-financing activity which will charge each "customer", whether a UNICEF country office or a procurement services client, a fee for the service of purchasing and delivering the requested supplies.

The self-financing Supply Division

15. Creating a self-financing Supply Division will require that the manner in which the UNICEF budget is presented be revised. All the costs of the Supply Division will be financed from a charge to UNICEF-assisted programmes and procurement services customers made for the provision of purchasing and warehousing services.

16. The Division's income will be generated by charging a fee for the purchase of supplies and equipment for direct shipment and from the overhead charge on purchases for warehouse re-stocking. The fee would be a fixed percentage of the cost of purchases against general resources, supplementary funds and procurement services orders.

17. The procurement services account would continue to be managed separately, but all income to the account, after the payment of staff and related costs, would be credited to the general Supply Division account. The first charge on the income generated from general resources and supplementary funds activity would be for staff and related costs.

18. The 1994-1995 budget provides for staff costs to be split as follows: (a) general resources, 40 per cent; (b) supplementary funds, 40 per cent; and (c) procurement services, 20 per cent.

19. All other operational costs of the Supply Division will be offset against the income generated.

20. An accounting system appropriate to the needs of the cost-recovery process will be established, although the presentation of the Supply Division budget will continue to follow the format mandated by the Executive Board. The overhead costs will be applied to "production" (inventory and purchasing costs) through the full cost or absorption costing method, i.e., a cost accounting system wherein the full costs of producing the goods are "absorbed by" or charged as product cost. At the end of the year, income exceeding the actual costs would be credited to general resources as miscellaneous income. If the costs of the Supply Division operation exceed the income generated, the excess will form an additional charge to the budget in the same manner as costs exceeding allotments are presently covered. It is unlikely that the cost-recovery process envisaged would result in expenditure greater than the allotment, but that possibility should be foreseen.

21. The following advantages will result from the Supply Division operating as a self-financing unit:

(a) The price of warehouse items will be reduced by the difference between the currently applied overhead and that necessary to cover actual costs;

(b) The UNICEF budget will be simplified by the correct charging of warehouse costs into a revised category III. Labour in the warehouse will become an integral part of the overhead recovery and packing materials will be charged to each shipment as a warehouse stock item;

(c) Accounting, monitoring and controlling as a self-financing unit will provide:

(i) A more accurate basis for establishing and adjusting the predetermined overhead recovery rate;

(ii) A clear basis for measuring the cost of operations and for strengthening internal operational controls;

(iii) A tool for the control of expenditure;

(d) Compliance with generally accepted accounting practices and auditing standards;

(e) The proposal is fully consistent with the concept of financial accountability.

Cost recovery

22. There will be four categories of activity that will bear a charge: (a) direct warehouse costs; (b) indirect warehouse costs; (c) indirect costs of goods not shipped through the warehouse; and (d) procurement services.

23. In order to illustrate the concept, the following assumptions are made:

(a) Warehouse throughput for the biennium 1994-1995 will be $200 million;

(b) Purchasing for direct shipment in 1994-1995 will be $500 million (general resources and supplementary funds purchases combined);

(c) Procurement services income in 1994-1995 will be $5 million;

(d) The total Supply Division operating cost for the 1994-1995 biennium will be $45 million.

It is also assumed that administrative and programme support budget plus staff costs and travel and training for staff will be funded from procurement services income and from the recovery charge on supplementary funds (see E/ICEF/1994/AB/L.2).

24. The recovery of Supply Division expenses will be assured in the following manner: a charge, calculated as a percentage of the value of a transaction, will be levied on all warehouse issue orders and on all purchase orders placed for direct shipment against UNICEF funds.

25. Assuming a warehouse throughput of $200 million during the biennium 1994-1995 and direct costs of 5 per cent and indirect costs of 4 per cent for the operation of the warehouse during this period, an income of $18 million would be generated, that is 9 per cent of $200 million.

26. Assuming a purchase order value of $550 million during the biennium and estimating the costs of purchasing at 4 per cent of that value, an income of $22 million would be generated.

27. Assuming that procurement services income would continue at the 1993 level, $5 million would be generated.

28. Therefore, the total income would be $45 million. The Supply Division budget for the biennium is estimated at $43 million. This example uses the 1994-1995 biennium budget as an illustration of the proposed mechanism.

29. The accounting procedures to accommodate the cost-recovery process will be developed separately.

30. The current level of charges for procurement services (6 per cent for warehouse and vaccine orders and 8 per cent for direct shipment transactions) will be retained. Since the number of staff charged to this source of income has been reduced, it has been established that the current charges cover the expected expenditure.

31. Clarity of budget presentation and a direct relationship between the provision of services and the cost of those services will permit an accurate assessment of the cost of supply input to country programmes.